REPORT OF THE 2011 COMMITTEE STUDYING VIRGINIA ARBITRATION LAWS

The Boyd Graves Conference began its current study of Virginia's arbitration laws in 2008, when a committee was asked to consider whether the Conference should recommend adoption of a revised version of the Uniform Arbitration Act. The 2008 committee concluded that there was no compelling reason for major changes in Virginia's arbitration laws and declined to recommend adoption of the revised Act. Nevertheless, prompted by a concern that Virginia's arbitration laws might be improved by more modest changes, the Conference directed the committee to continue its study for an additional year, and to focus on whether there were problems with the existing law that should be addressed by curative amendments.

Following another year of study, which included a broad-based survey of the bar, the 2009 committee reported that it found no widespread dissatisfaction with Virginia's arbitration laws. It did, however, discover a related problem arising from the common practice of including mandatory arbitration clauses in most consumer contracts. The committee found that the use of mandatory arbitration clauses in consumer contracts has become pervasive in Virginia and that such contracts are often signed by individuals who do not have even a basic understanding of the terms to which they have agreed. The 2009 committee concluded unanimously that such contracts are inherently unfair and recommended that the committee's work be continued for an additional year so that the committee could consider whether and to what extent, under federal law, it might be possible to suggest a legislative remedy.

At the time the 2009 committee made its report, the committee was aware of two legislative proposals then pending in Congress that dealt with the use of mandatory arbitration clauses. The first, entitled *The Arbitration Fairness Act of 2009* (S 931 and HR 1020), was pending in both Houses of Congress. That Act, had it been approved, would have severely restricted the use of mandatory arbitration clauses in consumer, employment, and franchise contracts. The second proposal, also pending before the same session of Congress, would have created a Consumer Financial Protection Agency with broad authority to adopt regulations prohibiting or restricting the use of mandatory arbitration clauses in contracts issued by certain financial institutions. In addition to the two legislative proposals, the 2009 committee was concerned by two cases pending before the Supreme Court of the United States, both of which involved the validity of mandatory arbitration clauses in consumer contracts. The committee was fully aware that both separately and collectively, the fate of the two legislative proposals and the outcome of the two Supreme Court cases were almost certain to have a profound effect on any state action the committee might recommend.

The Conference approved the committee's recommendation and the committee continued its study during 2010. At the 2010 Conference, the committee reported that *The Arbitration Fairness Act of 2009* had stalled in Congress and that there was little chance that it would be adopted. However, the committee reported that Congress had passed the *Restoring American Financial Stability Act of 2010* (widely known as the Dodd-Frank Act) which, among other things, created a Consumer Financial Protection Bureau with explicit authority to regulate financial instruments containing mandatory pre-dispute arbitration clauses. The committee also reported that one of the two cases mentioned in its 2009 report, entitled *AT&T Mobility v. Concepcion, 2010 WL 303962,* was then pending undecided before the United States Supreme

Court. The AT&T case was directly on point and the committee felt that the final decision in that case would almost certainly determine whether the states have the power under federal law to restrict or prohibit mandatory arbitration clauses.

Under the circumstances, the 2010 Committee unanimously recommended that the Boyd Graves Conference take no action on the question of whether to recommend legislation restricting the use of mandatory arbitration clauses. Instead, the Committee recommended that the arbitration study be continued for an additional year so that the Committee could consider the impact of the pending decision of the Supreme Court in *AT&T Mobility v. Concepcion.* The Committee was also interested in determining whether and to what extent the newly established Consumer Financial Protection Bureau would exercise its statutory authority to regulate mandatory arbitration clauses in consumer contracts.

This Report covers the work of the 2011 Committee, and includes its recommendations.

The Decision of the U.S. Supreme Court in *AT&T Mobility v. Concepcion*

On April 27, 2011, the Supreme Court issued its final Opinion in *AT&T Mobility v. Concepcion.* The case holds that any effort by the states to declare mandatory arbitration clauses in consumer contracts to be unconscionable and invalid is precluded by the provisions of the Federal Arbitration Act.

As previously noted, this Committee, which has been studying this issue for the last four years, has repeatedly concluded, without dissent, that the practice of including mandatory arbitration clauses in consumer contracts of adhesion is inherently unfair and unconscionable, and that it should be against the public policy of the Commonwealth. It is clear that if the Committee felt that the Commonwealth had the authority to outlaw the practice; it would recommend that the General Assembly do so. Because of its continuing concern with the impact of the practice on Virginia consumers, the Committee has given meticulous consideration to the opinion of the Supreme Court in the *AT&T Mobility* case. With great reluctance, the Committee initially concluded that under the decision in *AT&T Mobility*, the Federal Arbitration Act effectively preempts any authority the states might otherwise have to proscribe the use of mandatory arbitration clauses in consumer contracts and therefore, it is impossible for the states to take effective action to deal with the problem such clauses create for consumers.

Then came the decision of the West Virginia Supreme Court in *Brown v. Genesis, 2011 WL 2611327 (W.Va. June 29, 2011).*

The Decision of the West Virginia Supreme Court in *Brown v. Genesis*

On June 29, 2011, almost two months to the day following the decision of the United States Supreme Court in *AT&T Mobility v. Concepcion,* the West Virginia Supreme Court issued its opinion in *Brown v. Genesis.* The case involves the validity and reach of a West Virginia statute declaring that the inclusion of a mandatory arbitration clause in a nursing home contract is against public policy and unenforceable. The West Virginia Supreme Court was fully aware of the decision of the United States Supreme Court in *AT&T Mobility* and cited that case on four separate occasions in its opinion.

The West Virginia Court had no difficulty in determining that the West Virginia statute outlawing mandatory arbitration clauses in nursing home contracts is preempted by Section 2 of the Federal Arbitration Act and the statute is therefore invalid. However, despite its ruling that the statute is preempted, the West Virginia Court declined to rule that all mandatory arbitration clauses in consumer contracts are valid. The Court pointed out that § 2 of the Federal Arbitration Act contains a "savings" clause that invalidates mandatory arbitration clauses in consumer contracts only if the contract containing the mandatory arbitration clause is itself valid under the law of the state in which it is made. For example, a gambling contract in a state in which gambling is against public policy, or a contract which is invalid because one of the parties lacks the capacity to contract, will not be preempted by the Federal Arbitration Act because it contains a mandatory arbitration clause. In such cases, the mandatory arbitration clause will not be enforced, not because the clause is invalid, but because the contract in which it is contained is invalid. The validity of a contract containing a mandatory arbitration clause is, according to the West Virginia Court, a matter of state law. In summary, *Brown v. Genesis* holds that although courts cannot invalidate mandatory arbitration clauses under rules applicable only to arbitration, they remain free to determine whether the contract containing a mandatory arbitration clause is itself valid under state law.

In a carefully crafted 42-page opinion, the West Virginia Supreme Court held that a nursing home contract mandating arbitration of personal injury claims, if executed prior to the occurrence of the injury, is against the public policy of West Virginia and will not be enforced. In reaching this conclusion, the Court observed:

> *Congress did not intend for arbitration agreements, adopted prior to an occurrence of negligence that results in a personal injury or wrongful death, and which require questions about the negligence to be submitted to arbitration, to be governed by the Federal Arbitration Act. We therefore hold that, as a matter of public policy under West Virginia law, an arbitration clause in a nursing home admission agreement adopted prior to the occurrence of negligence that results in a personal injury or wrongful death, shall not be enforced to compel arbitration of a dispute concerning the negligence.*

The members of the Boyd Graves Committee studying this issue are not in agreement with respect to the import of the *Brown v. Genesis* decision and it is not yet known whether that decision will be reviewed by the United States Supreme Court. Some members of the Committee feel that the case is inconsistent with *AT&T Mobility* and will not survive U.S. Supreme Court review. Other members of the Committee feel that the case was correctly decided and that the opinion provides an opening for the states to adopt legislation addressing the problems inherent in the inclusion of mandatory arbitration clauses in consumer contracts of adhesion. Still others feel that although *Brown v. Genesis* might not survive an appeal to the United States Supreme Court, it nevertheless suggests a possible approach to ending the practice of including mandatory arbitration clauses in consumer contracts, and for that reason the case deserves more careful attention than the Committee can devote in the time remaining before its report is due.

Despite this disagreement, and in deference to its feeling that every legitimate opportunity to address the problem should be pursued, the Committee is unanimous in recommending that the current study be continued for an additional year, but that the focus of the study be narrowed so as to include only the question of whether either the decision of the West Virginia Supreme Court in *Brown v. Genesis*, or rationales that case suggests, considered in light of the decision of the U.S. Supreme Court in *AT&T Mobility*, can provide a reasonable predicate for legislation addressing the serious problem of including mandatory arbitration clauses in consumer contracts of adhesion.

The Restoring American Financial Stability Act of 2010

This Act, commonly known as the Dodd-Frank Act, created a federal Consumer Financial Protection Bureau. Section 1028 of the Act contains the following provisions:

> *(a) The Bureau shall conduct a study of, and shall provide a report to Congress concerning, the use of agreements providing for arbitration of any future dispute between covered persons and consumers in connection with the offering or providing of consumer financial products or services.*
>
> *The Bureau, by regulation, may prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties, if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers. The findings in such rule shall be consistent with the study conducted under subsection (a).*

A "covered person" is defined as "any person that engages in offering or providing a consumer financial product or service, or an affiliate of such person."

The creation of the Consumer Financial Protection Bureau has proven to be a political "hot potato." The Bureau cannot function effectively without a Director, but the Congress has refused to confirm the Director nominated by the President and he recently withdrew the original nomination in favor of new nominee. Even so, the Republicans in the Senate have vowed to block any nominee unless the legislation that created the Bureau is amended to substitute a five member "Commission" in place of a single Director. The President could conceivably use his power to make a recess appointment if and when there is a Congressional recess, but whether he will do so is highly uncertain.

Thus, even though the Bureau has both a mandate to conduct a study of mandatory arbitration clauses in certain types of contracts, and the authority to regulate the use of such provisions once the study is complete, its ability to act is constrained by the absence of a Director and threatened by the ongoing efforts to replace the Director with a five member Commission. What the Bureau will ultimately do with respect to the issue, and when - if ever - it will do so, is unpredictable.

The Arbitration Fairness Act of 2011

Prompted by the decision of the Supreme Court in the *AT&T Mobility* case, several members of the Senate have re-introduced the *Arbitration Fairness Ac of 2011,* which appears to be fundamentally identical to the *Arbitration Fairness Act of 2009.* The 2009 Act was introduced in both the House and Senate but neither House of Congress took action on the bill. In view of the current composition of the Congress, the likelihood that the 2011 version will be approved and signed into law appears to be extremely remote.

Recommendation

In view of its inability to recommend that the General Assembly adopt legislation addressing the problems created by the inclusion of mandatory arbitration clauses in consumer contracts, and in view of the limited opportunity it has had to review the full significance of the decision in *Brown v. Genesis,* the Committee recommends: (1) that the Conference direct its chair, on behalf of the Conference, to advise each of the Commonwealth's representatives in Congress that the Conference has concluded that the practice of including mandatory arbitration provisions in consumer contracts is unconscionable, but because the General Assembly appears to be constrained by the decision of the United States Supreme Court in *AT&T Mobility v. Concepcion* from addressing the problem, the Conference urges Virginia's representatives in Congress to support efforts at the federal level to prohibit or regulate the use of such clauses in consumer contracts; and (2) that this study be continued for an additional year, but that the focus of the study be narrowed so as to include only the question of whether the decision of the West Virginia Supreme Court in *Brown v. Genesis,* and the approaches it might suggest, considered in the light of the decision of the United States Supreme Court in *AT&T Mobility v. Concepcion,* can provide a reasonable basis for legislation addressing the problems inherent in the inclusion of mandatory arbitration clauses in consumer contracts.

Respectfully submitted,

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